



ARIZONA STATE SENATE
Fifty-Third Legislature, Second Regular Session

AMENDED
FACT SHEET FOR S.B. 1392

TPT; digital goods and services.

Purpose

Creates parameters for determining the taxable status of digital goods and services at the state and local levels.

Background

Transaction privilege tax (TPT) is a gross receipts tax levied by the State of Arizona for the privilege of conducting business in the state. Unlike a "true" sales tax imposed by many other states, TPT is imposed upon the seller of the item being taxed, rather than the purchaser. While the burden of the tax may be passed on to the purchaser, the seller is the party that is ultimately liable for payment of the tax to the state. TPT is currently imposed under 16 separate business classifications, including mining, retail, commercial lease, restaurant and personal property rental. Arizona cities and towns impose their own *municipal privilege taxes* under the Model City Tax Code (MCTC) under many of the same, or similar, business classifications as found in state statute.

According to the Arizona Department of Revenue (DOR), software and digital goods are generally taxed under the retail and personal property rental classifications. The retail classification applies to gross income a business derives from the sale of *tangible personal property* (TPP), with exceptions. TPP is broadly defined as personal property which may be seen, weighed, measured, felt or touched, or is in any other manner perceptible to the senses. The personal property rental classification applies to gross income derived from leasing or renting TPP (A.R.S. §§ [42-5001](#); [42-5061](#); and [42-5071](#)). Gross income derived from the sale of computer software is considered taxable, regardless of the method that a retail business uses to transfer the software to its customers. Gross income derived from the creation or modification of computer software for use by an individual customer, however, is tax exempt ([A.A.C. R15-5154](#)).

Cities and towns apply the same essential interpretation of taxability as the state with respect to software and digital goods. Municipal taxation of gross income derived from leasing, licensing for use or renting TPP is addressed under [MCTC § 450](#) while taxation of gross income derived from selling TPP at retail is addressed under [MCTC § 460](#). Compared to state statute, MCTC is more explicit regarding the taxability of software, both in terms of definitions and regulatory treatment ([MCTC § 115](#) and [MCTC Reg. 115.1](#)).

The Ad Hoc Joint Committee on the Tax Treatment of Digital Goods and Services (Committee) was established on June 8, 2017, by President of the Senate Steve Yarbrough and Speaker of the House of Representatives J.D. Mesnard, and expired on December 31, 2017. In its findings, the Committee concluded that businesses, taxpayers, DOR and local taxing authorities

need statutory direction regarding what constitutes a taxable event for digital goods and services and recommended that the Legislature consider legislation intended to provide such clarity during the 2018 session.

The fiscal impact to the state General Fund associated with this legislation would depend on how TPT and use tax revenues are impacted by its taxability, tax exclusion and sourcing provisions.

Provisions

1. Excludes the following from TPT, use tax and local excise tax:
 - a) gross income, gross receipts or gross proceeds derived from the sale, lease or licensing of specified digital services; and
 - b) gross income, gross receipts or gross proceeds derived from the sale, lease or licensing of specified digital goods that are remotely accessed by a customer and not transferred electronically to the customer.
2. Specifies that the following activities do not change the characterization of any specified digital good or specified digital service as being excluded from tax:
 - a) the ability to receive, view, save, listen to or print a specified digital good or the output of a specified digital service;
 - b) the transfer of any transitory or temporary downloaded files, such as cache files; or
 - c) the transfer of any transitory or auxiliary application, including applets, cookies or plug-ins.
3. Specifies sourcing for prewritten computer software and specified digital goods as follows:
 - a) to the seller's business location, provided that the seller receives the order at an Arizona business location; and
 - b) to the purchaser's location in Arizona, provided that the purchaser receives the order at a business location outside of Arizona.
4. Clarifies that the following are included under the retail classification for TPT and use tax purposes:
 - a) the sale, rental or licensing for use of prewritten computer software, regardless of delivery method; and
 - b) the sale, rental or licensing for use of specified digital goods transferred electronically.
5. Allows a city or town to impose a retail TPT or use tax on the following under the MCTC, subject to the transaction sourcing criteria outlined above:
 - a) the sale, rental or licensing for use of prewritten computer software, regardless of delivery method; and
 - b) the sale, rental or licensing for use of specified digital goods transferred electronically.
6. Prohibits a city or town from levying a TPT, sales, use or other similar tax on the following:
 - a) specified digital services; or
 - b) specified digital goods that are remotely accessed and not transferred electronically.

7. Specifies that the ability to receive, save or print an output file or any temporary downloaded file from any specified digital service does not change the characterization of that specified digital service as an excluded service.
8. Specifies that the above exclusions from tax do not apply to services that are provided by persons who are subject to tax under the online lodging marketplace classification.
9. Defines *computer*, *computer software*, *computer software maintenance contract*, *prewritten computer software*, *remotely accessed*, *specified digital goods*, *specified digital services* and *transferred electronically*.
10. Contains a legislative intent clause.
11. Makes technical and conforming changes.
12. Becomes effective on the first day of the month following the month of the general effective date of the Fifty-third Legislature, Second Regular Session.

Amendments Adopted by Committee

1. Removes provisions relating to multiple points of use certificates.
2. Specifies use tax applicability to prewritten computer software and specified digital goods transferred electronically.
3. Makes various technical, conforming and clarifying changes.
4. Adds delayed effective date.

Senate Action

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Prepared by Senate Research

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